United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

To be argued by
EDWARD LABATON

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ORIGINAL

74-2038

SAMUEL PARKINSON, as Custodian for ANDREW PARKINSON, JONATHAN STAEBLER and PETER MYGATT,

Plaintiffs-Appellees,

-against-

APRIL INDUSTRIES, INC., ARTHUR FEDER, MORRIS DEMEL, NATHAN APTEKAR and STANLEY SILVER,

Defendants-Appellants,

-and-

ALEX M. PARKER,

Defendant.

APPELLEES' BRIEF

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Preliminary Statement

Defendants, other than Parker, appeal from an order (77a)* of the United States District Court for the Southern District of New York (Knapp, J.) which granted plaintiffs' motion for an order declaring that the action be maintained as a class action pursuant to Federal Rules of Civil Procedure 23(c)(1).

The complaint is based upon §10(b) of and Rule 10b-5 under the Securities Exchange Act of 1934, and alleges that defendants artificially inflated the earnings of April Industries, Inc. ("April") and disseminated misleading projections of earnings and thereby manipulated the market price of April stock. The proposed class represents persons who purchased shares of April stock between June 1, 1972 and December 18, 1972, the period during which the statements were disseminated.

The District Court specifically found the following:

1. That Rule 23(a)(1) was satisfied in that there was adequate proof that the class numbers several hundred persons and is so numerous that joinder of all members is impracticable (78a-79a).

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* Numerical references are to the appendix.

2. That Rule 23(a)(2) was satisfied in that statements were made by the defendants (a) to securities analysts and financial writers with the intent and purpose that they be disseminated to the public, and (b) with respect to the third quarter earnings statement directly to the investing public. On the basis of these facts, there appear to be questions of law or fact common to the class (citing Siegel v. Realty Equities Corp., 54 F.R.D. 420 (S.D.N.Y. 1972) (79a-82a).

3. That Rule 23(a)(3) was satisfied as plaintiffs' claims are typical of the class in that April disseminated the statements complained of between June 1, 1972 and plaintiffs Mygatt and Staebler purchased April stock on July 16, 1972 (82a), and plaintiff Parkinson purchased April stock on December 6, 1972.

4. That Rule 23(a)(4) was satisfied in that counsel for plaintiffs would adequately protect the interests of the class based upon vigor demonstrated by counsel in prior cases (82a).

5. That the defendants' contentions that Rule 23(b)(3) were not satisfied were without merit and that questions of law and fact common to the members of the class predominate

over any question affecting only individual members, and that a class action is superior to other methods for the adjudication of the controversy (82a-83a).

By notice of motion dated August 9, 1974, plaintiffs moved to dismiss the appeal as one taken from a non-appealable interlocutory order. That motion was denied without prejudice to renewal on this appeal.

Questions Presented

1. Is the interlocutory order granting class standing appealable in this case?

2. Irrespective of the appealability of the order, did the District Court err in holding that the action may proceed as a class action?

The Facts

The complaint asserts that April and the other defendants comprising officers and directors (including controlling stockholders) in violation of Rule 10b-5 under the Securities Exchange Act of 1934 (17 CFR 240.10b-5) perpetrated a fraud upon the investing public between the period of June 1, 1972 and December 17, 1972, by issuing a series of false and misleading statements relating to the earnings and prospects of April and by making reckless predictions as to

its future earnings. The statements were made directly to the investing public and to various securities analysts with the intention that the securities analysts disseminate such false and misleading statements to the public. Among the statements disseminated were a prediction that April would have net profits of $1,890,000 in 1972 and a profit of $2,554,000 in 1973 and that earnings in the first, second and third quarters of 1972 were substantial. ($335,765 for the three months ended March 31, 1972, $431,860 for the three months ended June 30, 1972 and $336,773 for the three months ended September 30, 1972, or a grand total of $1,135,398 for the nine months ended September 30, 1972). On December 17, 1972, April corrected its report for the nine months period ended September 30, 1972, showing a loss for the three months ended September 30th. On April 11, 1973, April announced that it had sustained a net loss of $250,270 for the year ended December 31, 1972.

The false and misleading statements are contained in market letters, copies of which were annexed to plaintiffs' affidavit in support of their motion as Exhibits B to F (24a-57a), and in April's third quarter earnings statement, annexed to that affidavit as Exhibit G (58a). While the precise number of the members of the class, persons who pur-

chased April stock in the period June 1, 1972 to December 17, 1972, has not yet been determined, Exhibit A (23a) demonstrates that more than 450,000 shares were purchased in that period and on the basis of the trading, as well as the large number of market letters recommending April, it is reasonable to infer that the number of purchasers exceeds 500. The defendants who have control of April's stock transfer records did not introduce any contrary evidence.

The named plaintiffs acquired their stock between June 1, 1972 and December 18, 1972 and at prices ranging from 9-1/8 to 13-5/16. Two of the named plaintiffs sold their stock at a price of 4-3/4 and one of the plaintiffs retains his stock which at the commencement of the action was trading at approximately $2.00 a share.

POINT I

No Circumstance Exists at Bar to Justify This Court's Review of the Order Granting Class Action Status

Two recent cases decided by this court make it clear that a class action determination is appealable only in exceptional circumstances. Kohn v. Royall, Koegel & Wells, 496 F.2d 1094 (2d Cir. 1974); General Motors Corp. v. City of New York, 501 F.2d 639 (2d Cir. 1974).

An order granting or denying class standing is, of course, not a final order (Kohn at 1097). By May of 1974, the rule in this circuit was apparently that only where there was a proper application of the "death knell" doctrine, or where one of the three following conditions was met, was a class determination appealable:

1) Whether the class action determination is fundamental to the further conduct of the case;

2) Whether review of that order is "separable from the merits";

3) Whether the order will cause irreparable harm to a defendant in terms of money spent in defending a huge class action (Kohn, at 1098 citing Eisen v. Carlisle & Jacquelin, 479 F.2d 1005 (2d Cir.)., U.S. (1974). See also Herbst v. International Telephone and Telegraph, 495 F.2d 1308, 1312 (2d Cir. 1974).

Following Kohn, this court distilled the guidelines of appealability still further by adopting the three elements listed above. The "death knell" doctrine was subsumed within the first element. General Motors, supra, at 644.

An examination of the three pronged test for appealability and the application of each prong to this case conclusively point to the non-appealability of the order below.

Prong I: Fundamentality

The court in Kohn determined that the "fundamental-to-the-further-conduct" requirement was satisfied where "the action's viability turns on the class action determination" (Kohn at 1099). Appellee Parkinson's damages are in excess of $3500. The damages of appellees Mygatt and Staebler exceed $8500. With claims in these amounts, appellees had sufficient losses to pursue actions even had the class action motion been determined adversely to them. In Milberg v. Western Pacific Railroad, 443 F.2d 1301 (2d Cir. 1971), this court held that denial of a class action motion was not appealable because it was not the death knell of the case in that the plaintiff's damages were sufficiently large to warrant prosecution of the case without reference to whether or not it was a class action. In Milberg, the alleged damages were $8,500; here, the damages are about 50% higher than that amount. See also General Motors, supra, at 645. Thus, the first prong of appealability is lacking at bar.

In Kohn, this court so much as said that absent the "fundamentality" prong alone there is no interlocutory appeal. The court stated that

> Appellants' failure to demonstrate the "fundamental" nature of this class action determination . . . virtually requires dismissal of the appeal.

(496 F.2d at 1100). Because of the absence of the "fundamentality" prong here, the appeal should be dismissed.

Prong II: Separability

Appellants' brief makes clear that a review of the class action determination here must inevitably take this court into an examination of the merits of the appellees' allegations. Point I of appellants' brief raises the issue that "Plaintiff (sic) failed to sustain their burden of establishing that questions of law or fact common to the members of the class predominate" (App. br. p. 5). Point II vigorously asserts that there is no merit to plaintiffs' claims (App. br. p. 10). Point III contends that there was inadequate proof to establish the size of the proposed class (App. br. p. 13).

These issues are patently and "inextricably intertwined with the ultimate merits of . . . [the] claim for relief" (Kohn at 1100).

This court is being asked to determine issues of law and fact which go to the very heart of the appellees' substantive claims. In fact, appellants have themselves drawn a consideration of the merits into this appeal in the second point of their brief. As this court said in General Motors, supra, where a similar probing into the merits was sought on the appeal from the interlocutory appeal:

> The redundancy of effort and consequent waste of judicial resources must be apparent; accordingly, we shall not belabor the point.

(501 F.2d at 645). Thus, the second prong of appealability is lacking as review of the order is not separable from the merits.

Prong III: Irreparable Harm

While the exact number of members in the class is not presently known, the appellees have alleged that there are at least 500 members. The court below said that it is reasonable to assume "that several hundred persons bought stock during the relevant period" (79a). This number does not even remotely approach the thousands or, indeed, millions encountered in Eisen, supra, and Herbst, supra. The procedural costs, especially the cost of notice, will be borne by the plaintiffs as they must following the Eisen decision. Lastly, were the appellees to sue individually, there would be broad discovery and evidentiary admissibility at trial as to the issues of fraud and market manipulation by the appellants. Hence, the incremental cost of defending the action should not be significant.

Each of the above considerations were discussed in General Motors, supra, where this court held that there would be no irreparable harm to the defendants. As was said in Kohn:

> All lawsuits are potentially costly and time-consuming. Attention, therefore, must be directed to the incremental cost and time in defending the particular action if it is maintained as a class action -- an insignificant amount in this case.

(496 F.2d at 1100). The incremental cost and time needed to defend the suit here are no less insignificant.

In Herbst, supra, Judge Mulligan expressed "grave doubt" that the order granting class action status is appealable but stated that he was not inclined to depart from Eisen III, which was then on appeal in the Supreme Court. Judge Danaher, referring to Judge Mulligan's concurrence, stated:

> What amounts to "grave doubt" in Judge Mulligan's view is for me a persistent perturbation. I had supposed that 28 U.S.C. Section 1291 would limit our review jurisdiction to "final" decisions of the district court.

(495 F.2d at 1308).

When Eisen III finally reached the Supreme Court, that court held that this court had review jurisdiction on the basis of Cohen v. Beneficial Loan Corporation, 337 U.S. 541 (1949). The Supreme Court held that the district court's determination that defendants be required to bear 90% of the cost of notice was a final disposition of a claim of right which was not an

ingredient of the cause of action asserted by the plaintiff and did not require consideration with that cause of action (40 L.Ed. 2d at 745). Here, no notice costs were assessed against the defendants. There was no final disposition of any claim of right which was not an ingredient of the claims asserted in the complaint. Here, the district court's finding was tentative or incomplete in that under Rule 23(d) F.R.C.P. any class action "may be altered or amended as may be desirable from time to time".

Hence, the "grave doubt" and the "perturbation" expressed by two of the three judges on the Herbst case, together with the holding in Eisen and the subsequent holdings in Kohn and General Motors, indicate that there is no appealable order and that this appeal should be dismissed. Judge Danaher's observations in Herbst are particularly apt on this appeal. This is a garden variety securities fraud class action. Dozens of similar cases have been managed as class actions in this circuit. As this court observed in Eisen:

> From our extensive study of the whole situation in working on this Eisen case it would seem that amended Rule 23 provided an excellent and workable procedure in cases where the number of members of the class is not too large.

(479 F.2d at 1019).

This court specifically rejected any suggestion that Eisen III broadened the rules governing appealability of orders granting class action status when it said in General Motors:

> . . . we find in Eisen a reaffirmation of the exceptional circumstances required to justify departure from the "final judgment" rule - circumstances not present in this case.

(501 F.2d at 646). As demonstrated above, those circumstances are also absent here.

Accordingly, this appeal should be dismissed.

POINT II

The Requirements of Rule 23 F.R.C.P. Have Been Met

This is a garden variety securities fraud class action. Although the appellants argue that the claim is based an oral misstatements or misrepresentations, the gravamen of the fraud is the dissemination of written reports. Those reports (24a-57a) were disseminated by securities analysts and financial writers based upon information supplied by appellants with the intent and purpose that such information be published and distributed to the investing public. Furthermore, one of the documents relied upon - the third quarter earnings statement (58a) - was disseminated directly by April. If the appellants' theory were taken to its logical conclusion, only the person who set the type for the reports and statements of the company could be liable for any false or fraudulent statements contained therein.

The decision below dealt cogently and succinctly with each relevant element of Rule 23 and held that plaintiffs had satisfied the four conjunctive requirements of Rule 23(a) as well as Rule 23(b)(3).

Rule 23(a)(1) [raised in Point II of appellants' brief]: There are at least several hundred members in the class (23a,78a-79a In Fidelis Corp. v. Litton Industries, Inc., 293 F.Supp. 164 (S.D.N.Y. 1968), Judge Bonsal held that the Rule 23(a)(1) requirement was met even though the class may have consisted of as few as 35 members. As the court below stated, citing Fischer v. Kletz, 41 F.R.D. 377, 384 (S.D.N.Y. 1966):

> the failure to state the exact number in the class does not preclude the maintenance of a class action.

Obviously, the number here satisfies the Rule and joinder is impractical.

Rule 23(a)(2) [raised in part in Point I of appellants' brief]: This action contains the "common factual nucleus" which is the hallmark of a securities fraud class action under Rule 23(b)(3). See Green v. Wolf Corporation, 406 F.2d 291, 299-300 (2d Cir. 1968) cert. denied 395 U.S. 977. Since Green, there have been many cases involving the "common factual nucleus", which clearly demonstrates that this action is a typical securities fraud class action. In re U. S. Financial Securities Litigation, CCH Fed. Sec. L. Rep. ¶94,844 (S.D. Cal. 1974); In re Memorex Security Cases, 61 F.R.D. 88 (N.D. Cal. 1973); In re National Student Marketing Litigation, CCH Fed. Sec. L. Rep. ¶94,165 (D.C. D.C. 1973); Esplin v. Hirschi, 402 F.2d 94 (10th Cir. 1968), cert. den. 394 U.S. 928 (1969); Fischer v. Kletz, supra; Berland v. Mack, 48 F.R.D. 121 (S.D.N.Y. 1969

Werfel v. Kramarsky, CCH Fed. Sec. L. Rep. ¶94,394 (S.D.N.Y. Jan. 31, 1974); Kronenberg v. Hotel Governor Clinton, Inc., 41 F.R.D. 42 (S.D.N.Y. 1966); Siegel v. Realty Equities Corp., supra.

If there were no class action, each class action member might have to prove, among other things, that identical written statements were false and misleading, that the said statements were the result of false and misleading statements by the defendants, and that the statements issued directly by April were false and misleading. There might be individual questions of reliance* but, as noted in Green v. Wolf Corporation, supra, such individual questions would await the outcome of the determination of the common questions.

Appellants rely (brief p. 8) on several cases in which individualized, oral or written representations were made separately to members of the alleged class. These cases were distinguished by the court below relying in part on Siegel v. Realty Equities Corp., supra (81a-82a). Here, as in Siegel, all of the misstatements are set forth in documents addressed to the general public. Here, as to the market reports, the

* To the extent that the 10b-5 claim is based upon omissions of material fact as opposed to affirmative misstatements, reliance is not a factor. Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128 (1972); In re U. S. Financial Securities Litigation, supra; Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F.Supp. 264 (S.D.N.Y. 1972), aff'd. 495 F.2d 228 (2d Cir. 1974).

appellants used the medium of securities analysts and brokers and dealers rather than a direct mailing to the public.* If anything, that conduct should make the appellants more culpable. If the law were otherwise, then the class action would be a tool for specialized frauds. In an article appearing in The Review of Securities Regulation, John F. X. Peloso (Chief Trial Counsel in the New York Regional Office of the Securities and Exchange Commission) stated:

> His [the security analyst's] role in the dissemination of information about corporate issuers makes him a particularly appropriate subject for regulatory scrutiny . . . [and] his role in gathering, analyzing, and disseminating information is both highly susceptible to misuse and of critical value to the securities' markets.

(Peloso, The Security Analyst, 7 Review of Securities Regulation 863 (1974)).

The common issues of law and fact all relate to the statements disseminated by April through the securities analysts or directly to the public. Parallel statements as to historical earnings and projections all appear in the analysts' reports (24a, 30a). Each market report or article projects April profits for the year 1972 within a very narrow range, the lowest being $1.25 to $1.30 a share (38a), and the

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* The appellants disseminated the third quarter earnings statements directly.

highest being $1.40 a share (24a, 44a). Each report emphasizes that April was able to operate profitably because of low labor costs and "vertical integration" - the absence of subcontractors. Most of the reports refer to growth possibilities in the Puerto Rican markets and most project earnings of $2,000,000 for 1973. Appellees allege that the appellants were the source for all of the information was the appellants'. In this connection, appellee Staebler testified that one of the analysts (Gruber) * visited Puerto Rico and received profit estimates of $1.30 a share from management (101a). The reporter for the OTC Chronicle similarly indicated that the source of his information was the president of April. ** The statement that April had a team of management and construction specialists which had forged a powerful and unique construction company appears in a brochure disseminated by April (110a-118a) and is picked up in substance in all of the reports by investment analysts. The nine month interim report disseminated on November 10, 1972 (Complaint ¶10) is a writing of April to its shareholders and to the investing public (58a-59a).

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* Appellants argue that Gruber accepted full responsibility for the statements in his report. Assuming that that question is relevant at this stage, it can hardly be claimed that Gruber was the source of the data which he transmitted to the public.

** "This writer attended a meeting last week with management of APRIL INDUSTRIES to find out more. This publication learned that . . ." (24a)

Rule 23(a)(3): The cases held that the primary indicium of the typicality of the representative party's claim is that such claim not be antagonistic to the claims of other members of the class. In Mersay v. First Republic Corp., 43 F.R.D. 465 (S.D.N.Y. 1968), where the court allowed an "insider" to maintain a class action, Judge Metzner stated that:

> Those interests [as an insider] are not in any way antagonistic to or in conflict with the interests of the class, and do not affect the typical issues which are the subject of the lawsuit.

(43 F.R.D. at 468). See also Green v. Wolf Corp., supra, at 299.

Appellees' claims are based on the actions of the appellants which culminated in the misleading financial statements, reports and press releases and they suffered the same type of damage when they purchased their shares as every other purchaser. There is nothing to indicate that appellees' claims are in any way atypical or antagonistic to the claims of the remaining members of the class.

Rule 23(a)(4): The primary test of adequacy of representation is the vigor with which plaintiff and his counsel prosecute the action. See Mersay v. First Republic Corp., supra, at 470. Judge Knapp, before whom appellees' counsel had previously appeared, was satisfied that this test was met (82a).

Rule 23(b)(3) [raised in part in Point I of appellants' brief]: So clear is it that common questions of law or fact predominate that the court below simply found that contentions to the contrary were without merit.

The only individual issue involves damages and since all class actions involve damages in varying amounts among the class members, such arithmetical variance has never been considered a bar to class actions. See DeMilia v. Cybernetics International Corporation, CCH Fed. Sec. L. Rep. ¶93,386 (S.D.N.Y. 1972).

Further, the class action is superior to other forms of adjudication. The instant action, based upon false and misleading oral and written statements to securities analysts, others in the securities industry and the investing public, has all the ingredients of numerous like actions which have been declared class actions in the recent past. Federal securities law litigation has long been recognized as a fertile field for the maintenance of class actions. Professor Loss has noted that

> The ultimate effectiveness of federal remedies . . . may depend in large measure on the applicability of the class action device.

(3 Loss, Securities Regulation, 1819 (2d Ed. 1961)).

The class action device is not just a superior method, but the only feasible one where, as here, those who have allegedly been injured "are in a poor position to seek legal redress, either because they do not know enough or because such redress is disproportionately expensive". Dolgow v. Anderson, 43 F.R.D. 472, 484 (E.D.N.Y. 1968).

If difficulties in managing this controversy as a class suit should later prove insurmountable, which is unlikely as this case is so routinely similar to other cases which have been successfully managed, the court's decision can be altered or amended, Rule 23(c)(1).

As the statutory prerequisites to the maintenance of a class action have been met, it is not essential to analyze appellants' brief. Suffice it to say that appellants argue as if they were moving to dismiss this action after trial. Rule 23 "does not require an advance trial of the merits on a class action motion" (Fogel v. Wolfgang, 47 F.R.D. 213, 215 n. 4 (S.D.N.Y 1969)).

Under their second point, at page 12 of their brief, appellants assert that appellees have failed to establish "any motivation for any alleged manipulation by the defendants". They go on to say that appellees did not show: that appellants profited from their acts; and that appellants knew the financial

reports were inaccurate when published. These issues, if they are relevant, go to the merits of the claims and have no bearing whatever on the class action motion.

In the same point, appellants urge that appellees have failed to establish that they are members of the class, "except for their dates of purchase" (App. br. p. 12) (emphasis added). In support of this proposition, which admits one of the fundamental bases of class membership, appellants cite three cases which are wholly inapposite. Smith v. Board of Education of Morrilton Sch. Dist. No. 32, 365 F.2d 770 (8th Cir. 1966) involved a claim of racial discrimination and allowed the action to be maintained as a class where seven persons constituted the class. Huff v. N.D. Cass Co. of Alabama, 468 F.2d 1972 (5th Cir. 1972) is also a discrimination case. In Huff, class status was denied after a Rule 23(a)(4) hearing. In fact, the court in Huff went on to say that

> Unless abuse is shown, the decision of a trial court as to whether a class action is properly brought is final . . .

(468 F.2d at 179).

Seligson v. Plum Tree, Inc., 55 F.R.D. 259 (E.D. Pa. 1972) held that the plaintiffs, as franchisees, could maintain a class action based upon alleged antitrust violations by the franchisor. That the plaintiffs had terminated their franchise agreement did not preclude either their claim or standing as representatives of the class.

Conclusion

The appeal in this matter should be dismissed. If it is not dismissed, the decision of the court below should be affirmed.

Respectfully submitted,

Shatzkin, Cooper, Labaton,
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Of Counsel:

Edward Labaton
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STATE OF NEW YORK
COUNTY OF NEW YORK

FRED LEIPER being duly sworn deposes and says: On December 18th, 1974 I served the within ~~record on appeal~~ brief ~~appendix~~ on Wilbur G. Silverman the attorney for the ~~respondent~~ appellants by ~~leaving~~ mailing ~~three~~ two copies thereof ~~to~~ at his office located at 88-11 169th Street Jamaica, New York 11432

Fred Leiper

Sworn to before me
this 18th day of
December 1974

Lillian Weisberg

LILLIAN WEISBERG
COMMISSIONER OF DEEDS
CITY OF NEW YORK 4-1401
Certificate filed in New York County
Commission Expires September 1, 1976